Remarks of Commissioner Linda K. Breathitt
Federal Energy Regulatory Commission

" FERC Activities and Horizons"

Sixth Gas Industry Standards Board Annual Meeting

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Good morning! Thank you for inviting me to address the Sixth Gas Industry Standards Board Annual Meeting. It is an honor to share the podium with my friends and colleagues from state regulatory agencies, and with the distinguished members of the Mexican and Canadian regulatory bodies. GISB has chosen as the theme for its 2000 Annual Meeting the convergence phenomenon that is sweeping the energy industry. This is certainly an apt topic in light of GISB's prominence as an agent of change on the convergence scene.

I have been asked to share with you my perspective of convergence as it relates to federal regulatory activities and horizons. As I do so this morning, it is with the recognition that the United States energy marketplace would look very different today without the unique partnership that has been forged between GISB and FERC. To me, perhaps the most striking aspect of the convergence phenomenon is the importance the dissemination of information has taken on in the energy marketplace. And one can hardly speak of a convergence of the gas and electric industries without also acknowledging a broader convergence of the energy and telecommunications industries in this information age.

Increased competition in both the gas and electric markets, in large part, set the stage for the transformation and convergence of energy markets. Historically, the focus on increasing competition and reducing federal regulations has been legislative, but FERC has also taken an active role in promoting competitive markets. And while the timing of restructuring in the gas and electric industries has been staggered, the overarching trend in the energy industry in recent years has been to move away from a command-and-control regime to a lighter-handed approach – where market power can be addressed through the protections that are inherent in competitive markets. Importantly, open-access and competition have shifted the regulatory focus, both at the federal and state levels, to the innovation of market-oriented solutions to regulatory problems.

FERC understands that the lack of timely and accurate pricing information can impede competition, and to that end, we are seeking to improve market transparency in each of the markets we regulate. We have taken steps to expand publicly available information in order to improve the industry's and regulators' ability to monitor the marketplace. It is our goal to give the market sufficient tools to allow market participants to detect market power abuses. I like to call this "regulation by information." A natural outgrowth of this basic regulatory goal is the need for standardized business practices and protocols – and for this, FERC relies heavily on GISB.

Standardization is also key to the development of electronic commerce in the energy industry. FERC has encouraged the development of eCommerce in the industries we regulate since the early 1990s, when GISB was first formed, in response to FERC's initiatives to develop a secondary market for released capacity through the use of Electronic Bulletin Boards. GISB was successful in developing standards for pipeline business and communications protocols, including practices for scheduling, transmission of flowing gas information, and invoicing. GISB has continued to work with FERC as the Internet has become the primary medium for eCommerce. I am convinced that the collaboration among the various industry sectors within GISB, and the Commission's willingness to adopt GISB's recommendations, has served to further, and accelerate, the development of an efficient marketplace. Now FERC and the electric industry face similar challenges as open access unfolds on the electric side.

The Internet revolution is allowing pipelines and utilities to implement our information-based regulatory initiatives in a cost-effective and efficient manner. In commodity markets, online sales of electricity are just emerging, but natural gas buyers have been using the Internet for some time. Electronic trading creates a more efficient market by expanding the number of buyers and sellers interacting, reducing the time and resources needed to obtain price information and consummate trades, and providing traders with more confidence in the prices they obtain. Electronic commerce also helps equalize the marketplace between large and small participants.

The rapid emergence of eCommerce has surpassed the expectations of many energy industry watchers. One study expects eCommerce to reach 20 percent of total gas business within two years. It has been estimated that online electricity sales alone will grow from $1 billion in 1999 to $100 billion in 2004. This expansion will come as wholesale markets continue to develop and business customers turn to the web to choose energy suppliers.

But not only does the Internet assist energy market participants to conduct their business more efficiently – the Internet revolution also contributes to the demand for electricity. There is a lot of variation in the estimates of how much electricity is, and will be, dedicated to computers and the Internet. But it is likely that the digital economy could shape energy consumption in a significant way. And in order to meet what has been called an Internet demand "Tsunami", utilities must improve reliability by developing a smarter, digitalized grid. Federal and state energy regulators are deploying significant resources on the need for reliability and responsible planning and expansion of the electric power grid.

The ongoing restructuring in electricity markets is having significant effect on gas markets. Gas for power generation is projected to grow 4.5% annually from 1997 through 2020. According to the North American Electric Reliability Council, about 90 percent of the announced new generating capacity will be gas-fired. This trend forms the basis for nearly everything we are currently doing on the natural gas side at FERC.

As all of you know, FERC recently completed a long process of reevaluating the way we regulate the natural gas industry, which culminated in the issuance of Order No. 637 in February of this year. It was during the Order No. 637 process that FERC began to recognize how much the integration of gas and electric markets has begun to influence the operation of the markets we regulate, and in turn, how we regulate convergence markets. Order No. 637 itself was not intended as a massive regulatory overhaul; rather, it was intended to make several important changes to the way FERC regulates the natural gas market in order to further competition - which in turn, sets the stage for convergence activity.

The Commission is devoting significant staff resources at this time to processing the compliance filings, which came in on a staggered basis this summer. These filings address such issues as segmentation and penalty structure, which require pipelines and their customers to work together to arrive at agreeable solutions. It is too early to predict how long it will take to process the filings, but I expect a number of them will require further procedures, such as technical conferences, to work out all the compliance details. Some pipelines already have made tariff filings to implement several optional aspects of the rule; we have accepted a number of proposals to lift the price cap on short-term capacity releases and modify the right of first refusal. Order No. 637 also adopted certain new transactional reporting requirements - and I understand GISB has been working diligently to develop standards to ensure and maximize the usefulness of the transactional data.

In large part because of the rapid changes that are occurring in the gas industry, Order No. 637 set in motion a continuing examination of the market and the relationship of FERC's rules to the market. This process began last week, on September 19, when FERC staff held the first in a series of technical conferences to assist staff in making recommendations to the Commission for long-term policies and planning. Through these conferences, the Commission hopes to take a more proactive approach to developing policies that reflect market realities. Many of the topics that the Commission has asked its staff to explore directly relate to changes in the market that have come about, or may come about, as a result of convergence.

The first conference last week focused on commodity markets and transportation policies and practices that will make these markets more liquid. As we anticipated would occur, participants delved into the effects of convergence on pipeline services. In the past year or so, several pipelines have implemented various hourly transportation services intended primarily to serve electric generators. A faster-paced natural gas market increases the need for pipelines to rely on the accuracies provided by electronic metering -- and pipelines are beginning to use their electronic capabilities to innovate new services targeted to all shippers. Many of these new services are related to automatic nominations, imbalance management, and imbalance penalty avoidance. Pipelines are also finding opportunities in the traditional seasonal differences between natural gas and electric usage. The Commission has accepted at least one proposal for a "reverse storage" service, which reverses the traditional injection and withdrawal seasons. Some summer transportation services also have been proposed.

As the pipeline sector innovates new services to serve the electric generation market, new issues continue to arise - and I expect that FERC will continue to rely on the gas industry, through GISB, to fashion resolutions that ensure that the needs of all consumers are met. In last week's outreach session, electric suppliers called on FERC to encourage pipelines to offer a firm tariff service that allows customers variable hourly deliveries on no-notice or short-notice conditions. Electric suppliers assert that they need more flexible services and nomination schedules to facilitate the growth of forward and day-ahead markets in the electricity industry.

It was suggested that it may also be necessary to change GISB's timeline for pipeline nominations and scheduling to allow gas supplies and transportation for generators to be synchronized with the electric day. Electric suppliers stressed the differences in load profiles between pipeline's traditional utility customers and natural gas turbines. Unlike traditional utilities, natural gas turbines may be called upon to run only a few hours a day. Depending on fuel prices, they may not be called upon for weeks - but must be prepared to start up and run at full capacity for several hours a day. Electric suppliers suggest that when the open-access pipeline services offered today were developed, before electric restructuring had begun, the needs of gas-fired generators to bid into next-day and forward electricity markets were not well understood.

It is too soon for me to take a position on how best to ensure that FERC's gas and electric policies compliment each other to meet the risk management needs of electric generators. I do not need to tell this audience how difficult it is to develop standards to suit parties with varied interests -- and here the added twist is that the electric day itself is not standardized on a national basis. But I do believe that forward electricity markets are essential for reducing price volatility and for moving toward competitive generation. The consistent message I have been hearing is that in both electricity and gas markets, it is critical that energy buyers have the ability to engage in risk management in order to decrease commodity pricing uncertainties. I strongly believe that we, as regulators, need to be careful to discern the difference between hedging to reduce exposure to pricing volatility, and mere speculating. It is a fine distinction, but one that is critical. Hedging is a useful tool to decrease uncertainty, while speculating to beat the market can increase the possibility of risk, and regulators are leery of that. It could even be said that failing to hedge is actually speculating.

I would also like to point out at this juncture that while I believe it is important for FERC to encourage the greater integration of the electric and natural gas markets, I recognize the concerns of existing pipeline customers that the flexibility built into some new services may have an impact on the quality of their existing services. This is a valid concern, and the Commission may find that it is prudent to monitor new services as they are implemented to determine what, if any, impact they may have. The Commission took this approach in many of the early filings to implement parking and loaning (PAL) services by requiring pipelines to file a report after the first year of operation. We may have to explore other ways to ensure that traditional customers continue to receive reliable service.

It is my hope that pipelines and all of their customers will collaborate to ensure that the needs of traditional and electric generation customers are met. Some of the tension I expect to see at the forefront is between standardization and innovation. While most industry participants seem to favor standardization in business practices and communications, there is less consensus on whether the Commission should encourage standardization of services. While some industry sectors are calling for standardization, others are expressing concern that standard services will stifle innovation and flexibility. I think we have a lot to consider in the coming year!

Future industry conferences are being scheduled, and I am certain that the convergence theme will be ongoing. The next conference, to be held in January 2001, will focus on affiliate issues. The increased integration of gas and electric markets can be seen in mergers between power generators and pipeline companies, as well as the number of marketers that resell both gas and electricity. This has prompted some market participants to urge regulators to look more closely at market concentration issues associated with these mergers. The third conference, to be held in April 2001, will focus on the need for performance-based rates or two-track regulatory models with different approaches for captive and non-captive customers.

In closing, the new environment created by competition in regulated industries has had a cataclysmic effect on traditional views of regulatory roles and responsibilities. The work FERC does is changing, and so is the way we do it. The ultimate goal, however, remains the same - for consumers to realize the benefits of competition through lower prices, greater service options, and enhanced reliability of service. And one thing is certain: in order to realize these goals, FERC must continue and nurture its ability to collaborate with the energy industry - through organizations such as GISB - to pave the way for competition and convergence.